



Minnesota

Department of Finance

April 2004

State Revenues \$33 Million Below Forecast In February and March

Net general fund revenues totaled \$1.927 billion during February and March, \$33 million (1.7 percent), less than anticipated. Net sales tax receipts were \$13 million more than forecast but receipts from the individual income tax, the corporate income tax, the motor vehicle tax, and other revenues and receipts were all below projected levels. Fiscal year 2004 receipts now total \$9.755 billion, 4.4 percent above fiscal year 2003 receipts at the end of the third quarter of the fiscal year.

Summary of Tax Receipts: (February - March 2004)

	<u>Estimate</u>	<u>Actual</u>	<u>Variance</u>	<u>Percent</u>
	-----	(\$ in millions)	-----	
Income	840.1	832.0	(8.1)	(1.0)
Sales	577.5	590.7	13.2	2.3
Corporate	192.3	166.6	(25.7)	(13.4)
Motor Vehicles	43.8	38.8	(5.0)	(11.4)
Other	<u>306.7</u>	299.2	<u>(7.5)</u>	<u>(2.4)</u>
Total	1,960.4	1,927.3	(33.1)	(1.7)

Corporate income tax receipts were \$26 million (13.3 percent) less than forecast. Declarations (estimated payments and payments accompanying extensions) were \$25 million below forecast and \$8 million below last years level. (See page 4) The motor vehicle sales tax was also significantly below forecast, but much of the motor vehicle sales tax is dedicated to transportation uses, so the loss in general fund revenues was just \$5 million. Variances for the individual income tax and the sales tax were small and well within normal bounds. A \$4 million shortfall in gross sales tax receipts was offset by smaller than anticipated sales tax refunds during the past two months. Insurance gross premiums tax receipts were nearly \$19 million above forecast, and mortgage and deed tax receipts \$4 million above forecast.

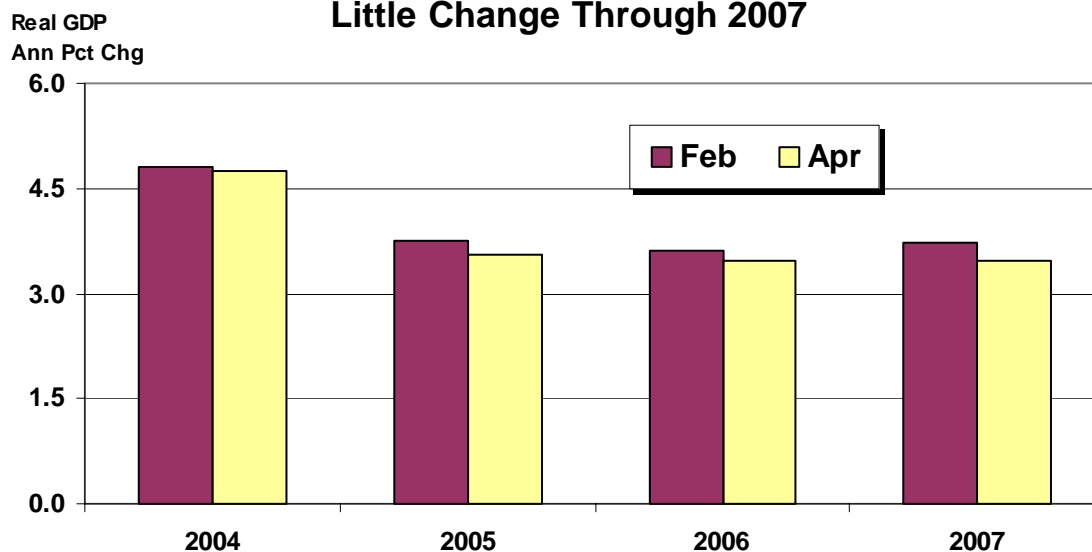
Individual income tax receipts include only withholding and individual estimated tax payments. Variances in tax year 2003 refunds and final payments are not reported during the tax-processing season. Those variances will be reported in July's *Economic Update*, after processing of all timely 2003 tax year returns has been completed.

March Employment Growth Hints Recovery is Finally Underway

March's payroll employment report was a welcome sight. For nearly two years forecasters have insisted that employment growth was just around the corner. At last, those predictions appear to be coming true. Several months of 200,000 plus growth in payroll employment will be needed before the economy can be said to be fully on track. But, the 308,000 jobs added in March are evidence that employers are finally ready to begin hiring, and forecasters everywhere are more confident that job growth is underway.

While noting it is important "not to overemphasize one month's numbers," Global Insight Inc. (GII), Minnesota's national economic consultant, acknowledges that the March employment report solidified their confidence in their baseline outlook. The GII April baseline forecast remains almost identical to February's, with real GDP growth rates of 4.7 percent and 3.5 percent projected for 2004 and 2005 respectively. In February annual growth rates of 4.8 percent and 3.6 percent were projected. GII's forecast for 2004 still calls for the strongest real GDP growth in 20 years.

Baseline Forecast for Real GDP Growth Shows Little Change Through 2007

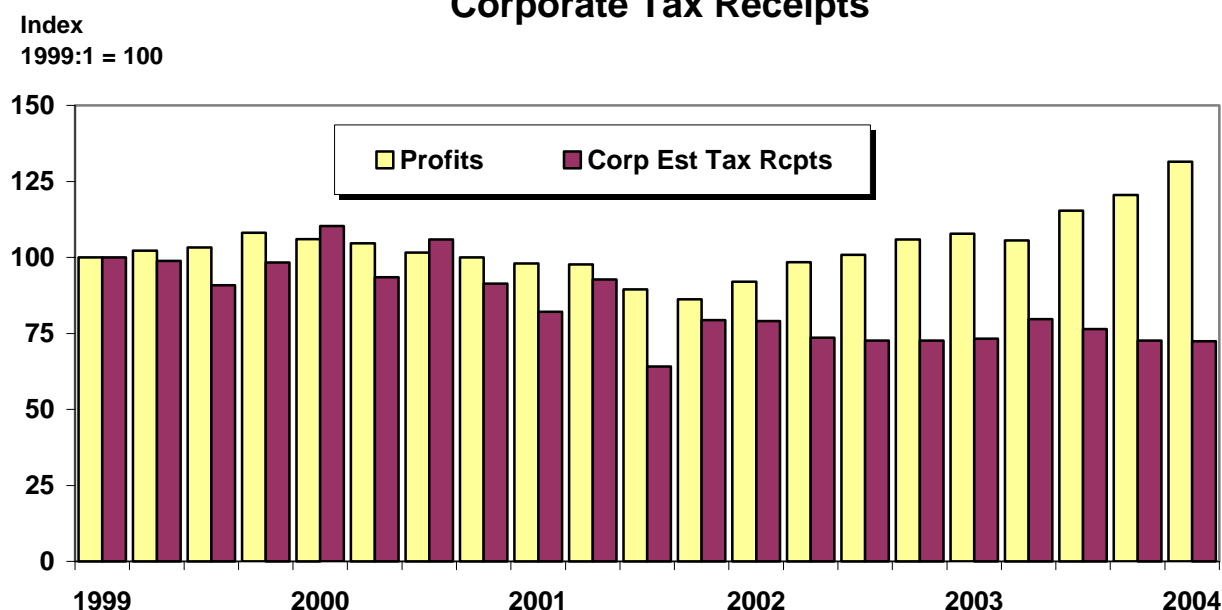


Some have feared consumer demand will weaken once interest rates start increasing and the most recent round of tax cuts work their way through the system. Employment growth, if it continues at last month's pace, will ease those concerns. Higher oil prices will be a drag on the economy, and another terrorist incident or a worsening of the geopolitical outlook in the Mideast or elsewhere would undoubtedly slow growth. But, there are no current excesses likely to create major short-term problems for the economy. Global Insight assigns a probability of 55 percent to their baseline forecast, 5 percent less than in February. A more pessimistic alternative, which has an extended period of slow growth but no recession, is given a 25 percent probability, and a more optimistic scenario, a 20 percent probability.

Corporate Franchise Tax Receipts Continue to Fall Short of Forecast

First quarter 2004 estimated corporate income tax payments in Minnesota were \$25 million (16 percent) less than forecast. This is the second large negative variance in a row in the corporate estimated tax. Fourth quarter 2005 corporate estimated tax receipts were \$33 million (22 percent) less than forecast. Despite widely reported increases in corporate profits, Minnesota's corporate tax receipts have fallen below the level received last year. As the graph below shows, even though corporate profits in recent quarters have grown to record levels, quarterly estimated corporate franchise tax payments and payments accompanying extensions are less than 75 percent of their 1999 level.

Rising Corporate Profits Have Not Produced Higher Corporate Tax Receipts



The lack of growth in the corporate tax does not appear to be attributable to federal bonus depreciation. The Finance Department's corporate tax estimates take explicit account of the difference between federal and state depreciation rules. Finance Department economists also made an off model reduction in their forecast of corporate estimated payments to take account of December's negative variance. February's forecast of first quarter 2004 estimated receipts was about \$17 million below November's projection, even though the outlook for corporate profits has improved.

Despite the off-model adjustment, March's estimated payments and extensions were again well below forecast, suggesting that a substantially larger off model reduction should have been made. If June's estimated payments are also below forecast, a material reduction in the projected corporate income tax receipts for the current biennium will be made in the next forecast.

Comparison of Actual and Estimated Non-Restricted Revenues

(\$ in thousands)

	2004 Fiscal Year-to-Date			February - March 2004		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
<u>Four Major Revenues:</u>						
<u>Individual Income Tax</u>						
Withholding	3,773,160	3,762,635	(10,526)	832,200	821,674	(10,526)
Declarations	596,200	598,581	2,381	7,985	10,367	2,381
Miscellaneous	112,878	112,878	0	0	0	0
Gross	4,482,239	4,474,094	(8,145)	840,185	832,041	(8,145)
Refund	109,528	109,528	0	0	0	0
Net	4,372,710	4,364,566	(8,145)	840,185	832,041	(8,145)
<u>Corporate & Bank Excise</u>						
Declarations	477,730	452,622	(25,108)	160,500	135,392	(25,108)
Miscellaneous	129,051	135,278	6,227	51,800	58,027	6,227
Gross	606,781	587,900	(18,881)	212,300	193,419	(18,881)
Refund	87,421	94,255	6,834	20,000	26,834	6,834
Net	519,360	493,645	(25,716)	192,300	166,584	(25,716)
<u>Sales Tax</u>						
Gross	3,046,967	3,043,032	(3,936)	625,200	621,264	(3,936)
Refunds	157,051	139,913	(17,139)	47,711	30,572	(17,139)
Net	2,889,916	2,903,119	13,203	577,489	590,692	13,203
<u>Motor Vehicle Sales</u>						
	202,586	197,633	(4,953)	43,753	38,800	(4,953)
<u>Other Revenues:</u>						
Inherit/Gift/Estate	68,088	70,633	2,545	11,941	14,487	2,545
Liquor/Wine/Beer	50,689	49,344	(1,345)	10,364	9,019	(1,345)
Cigarette/Tobacco/Cont Sub	117,779	117,069	(709)	21,735	21,026	(709)
Deed and Mortgage	250,773	254,763	3,991	36,828	40,819	3,991
Insurance Gross Earnings	192,053	210,635	18,582	82,000	100,582	18,582
Lawful Gambling	36,220	37,628	1,408	7,510	8,918	1,408
Health Care Surcharge	167,741	170,022	2,281	36,673	38,954	2,281
Other Taxes	1,056	1,286	230	(71)	159	230
state wide property tax	271,496	270,726	(770)	465	(305)	(770)
DHS RTC Collections	31,325	34,046	2,721	6,929	9,650	2,721
Income Tax Reciprocity	46,242	46,242	0	0	0	0
Investment Income	11,651	11,505	(146)	2,825	2,678	(146)
Tobacco Settlement	168,467	168,467	0	0	0	0
Departmental Earnings	206,053	196,064	(9,989)	42,647	32,658	(9,989)
Lottery Revenues	27,515	23,928	(3,587)	6,824	3,237	(3,587)
Revenues yet to be allocated	2,503	845	(1,658)	0	(1,658)	(1,658)
Residual revenues	177,320	157,250	(20,070)	43,627	23,557	(20,070)
Sales Tax Rebates (all years)	(4)	(2)	1	0	1	1
Other Subtotal	1,826,966	1,820,451	(6,514)	310,296	303,781	(6,514)
Other Refunds	23,069	24,094	1,025	3,574	4,599	1,025
Other Net	1,803,896	1,796,357	(7,539)	306,722	299,183	(7,539)
Total Gross	10,165,539	10,123,110	(42,429)	2,031,734	1,989,305	(42,429)
Total Refunds	377,070	367,790	(9,279)	71,285	62,005	(9,279)
Total Net	9,788,469	9,755,319	(33,150)	1,960,449	1,927,299	(33,150)